

California Debt and Investment Advisory Commission

Fundamentals of Debt Financing: The Role of the Underwriter

September 8, 2005

presented by

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Managing Director

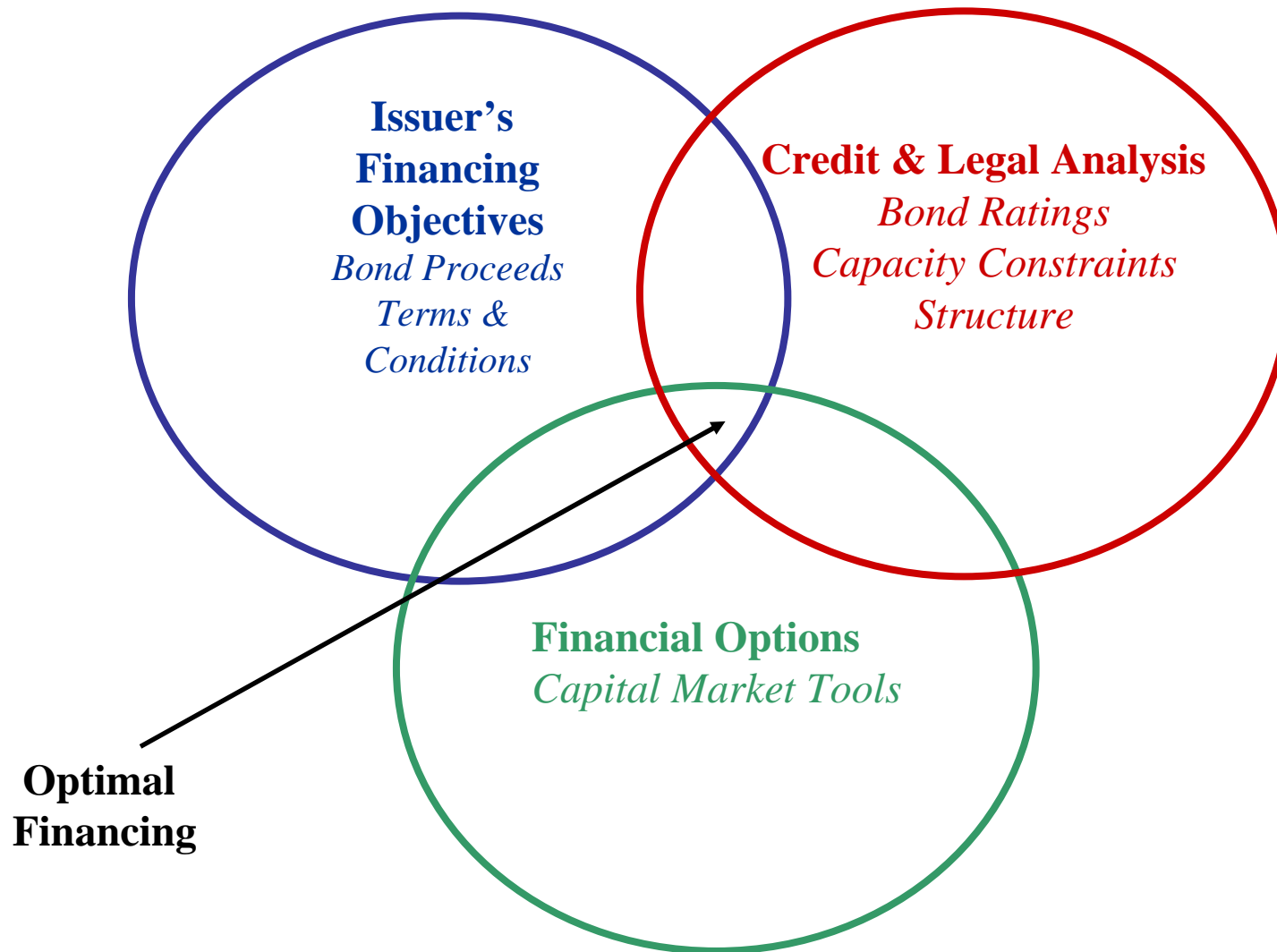


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YOUNGBERG

Introduction

- **The primary role of the underwriter is to purchase securities from the issuer and resell them to investors**
- **Underwriters act as intermediaries between issuers and investors, providing for an efficient flow of capital**
- **The underwriter takes the risk that it will be able to resell the securities at a profit**

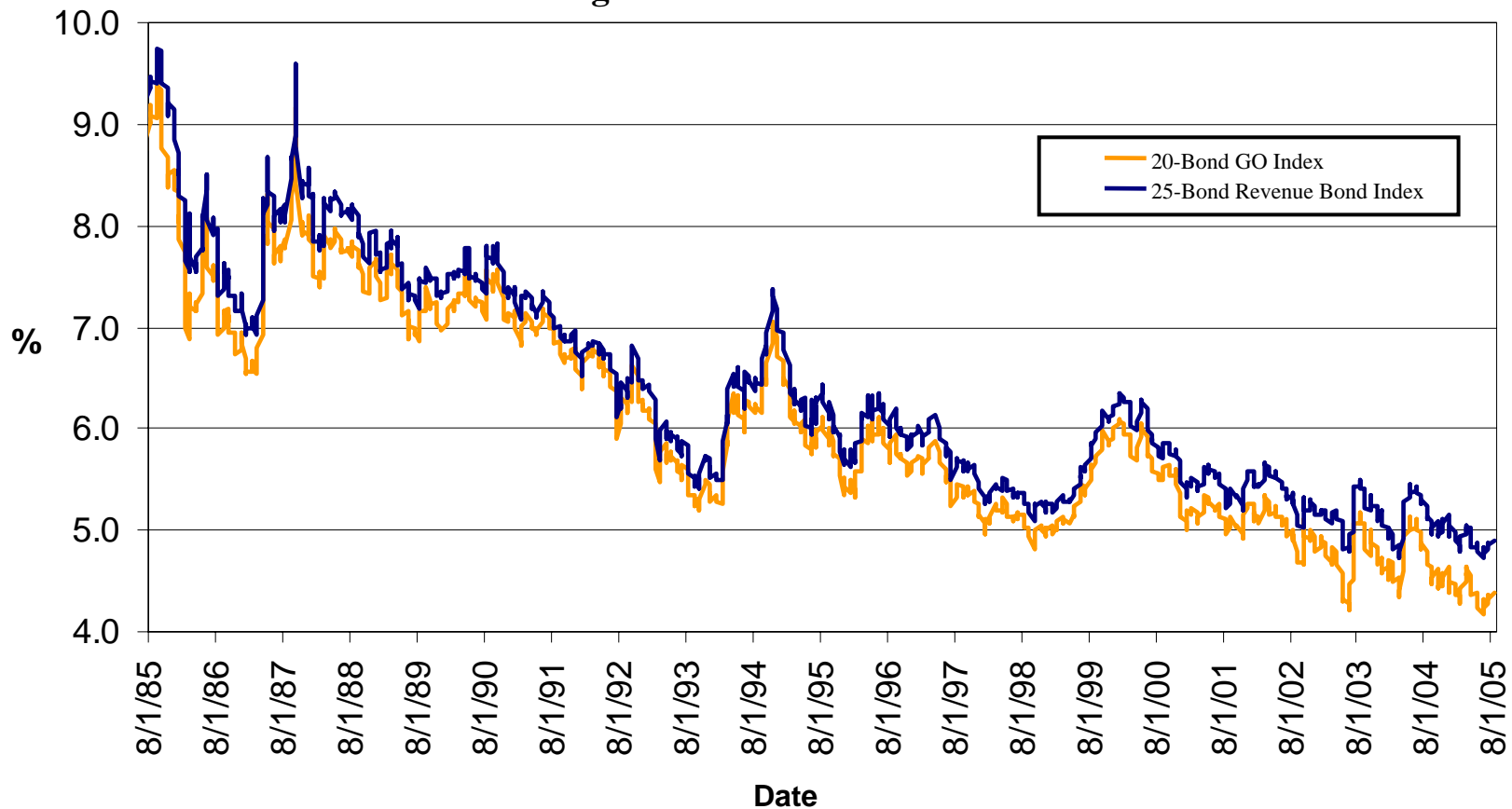
Role of the Underwriter



Municipal Market Overview

Interest Rate Comparison

General Obligation Bonds⁽¹⁾ vs. Revenue Bonds⁽²⁾



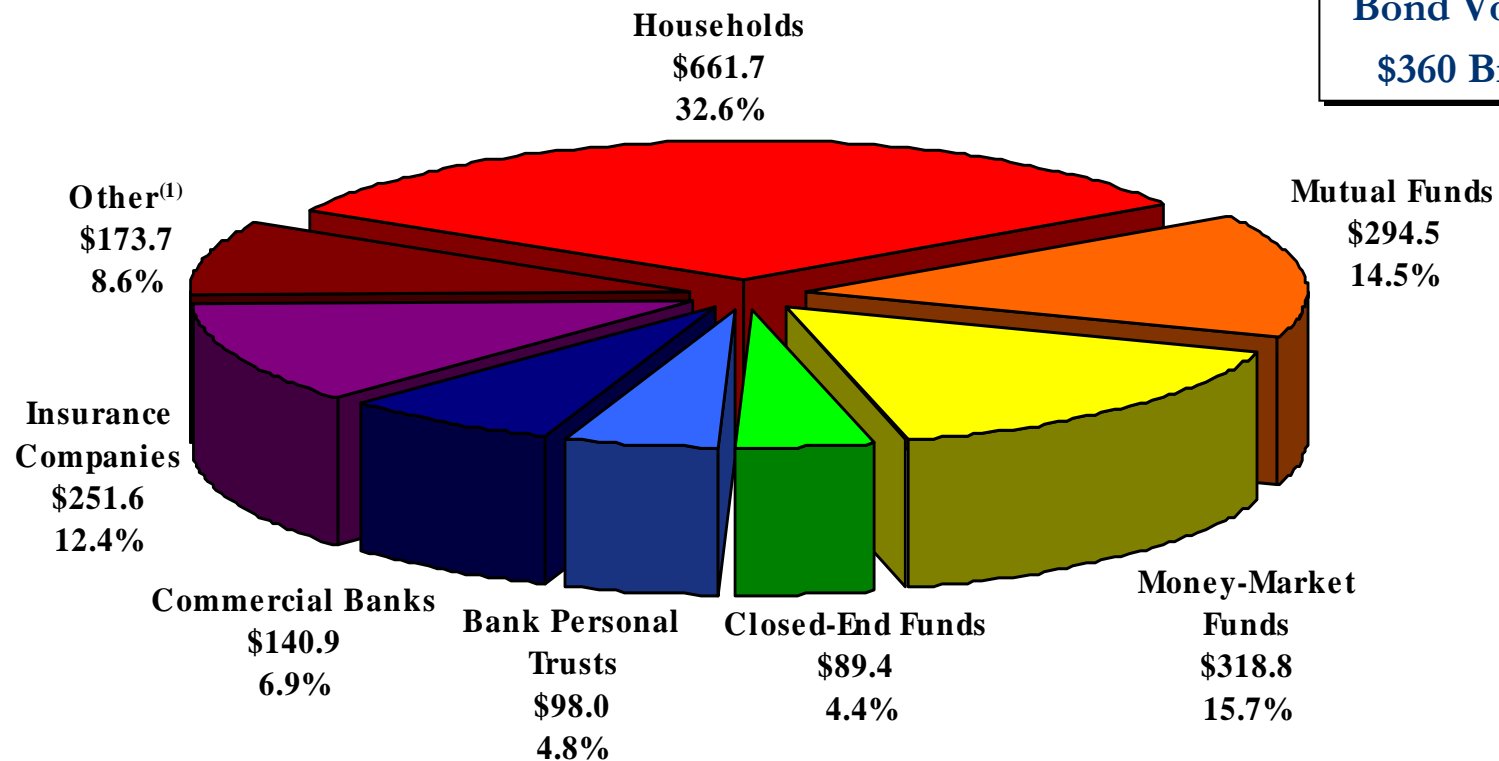
Source: The Bond Buyer

1. General Obligation Bonds maturing in 20 years are used in compiling this index. The average rating is roughly equivalent to Moody's Aa3 and Standard and Poor's AA.
2. Revenue Bonds maturing in 30 years are used in compiling this index. The average rating is roughly equivalent to Moody's A1 and Standard and Poor's A+.

Municipal Market Overview

2004 Holders of Municipal Bonds
(Dollars in Billions)

2004 National
Long-Term
Bond Volume:
\$360 Billion

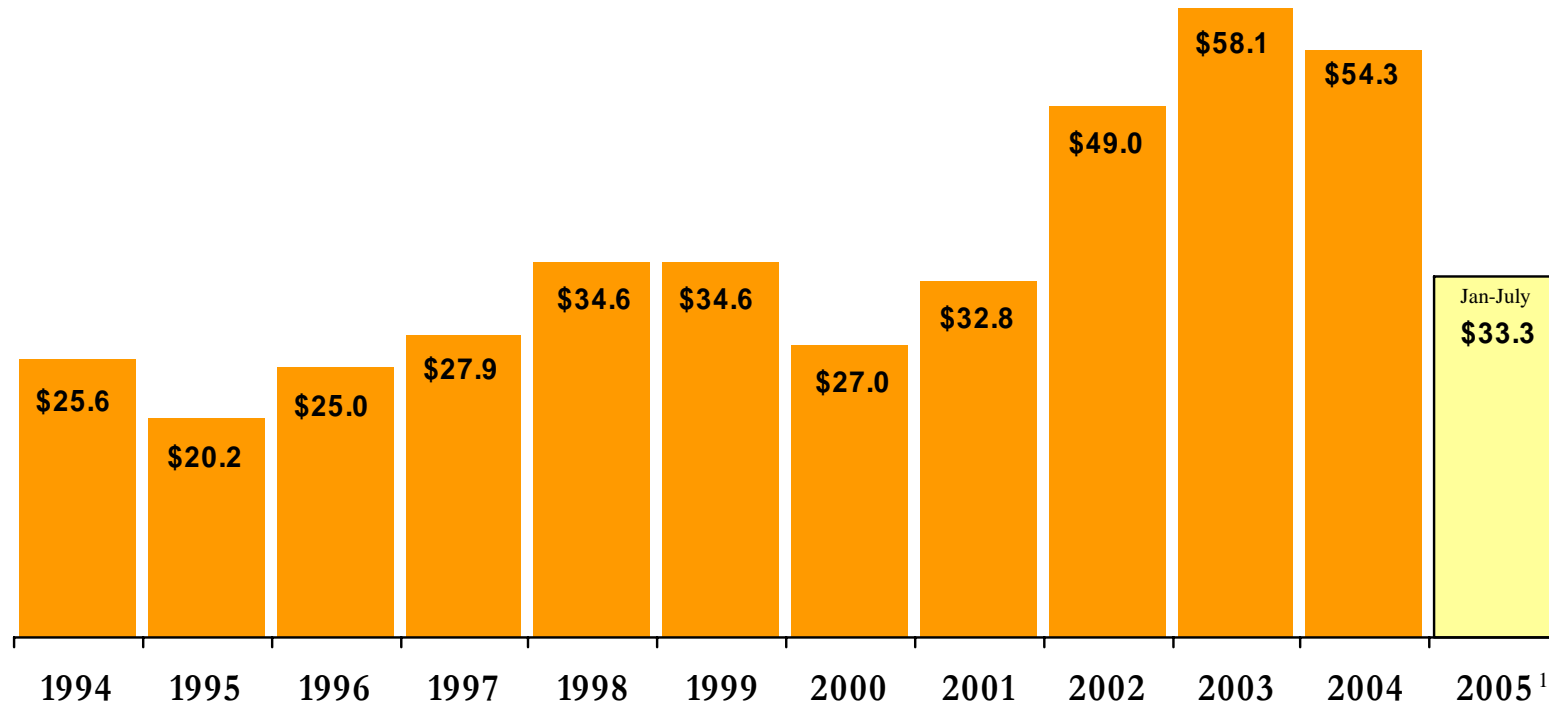


Source: Federal Reserve Board, as of December 31, 2004. (www.bondmarkets.com)

(1) Includes non-financial corporations, state & local government funds general funds, savings institutions, life insurance companies, private pension funds, state & local government retirement funds, broker/dealer and Government Sponsored Enterprises (GSEs)

Municipal Market Overview

Total Annual Dollar Amount of California Issues
(Dollars in Billions)



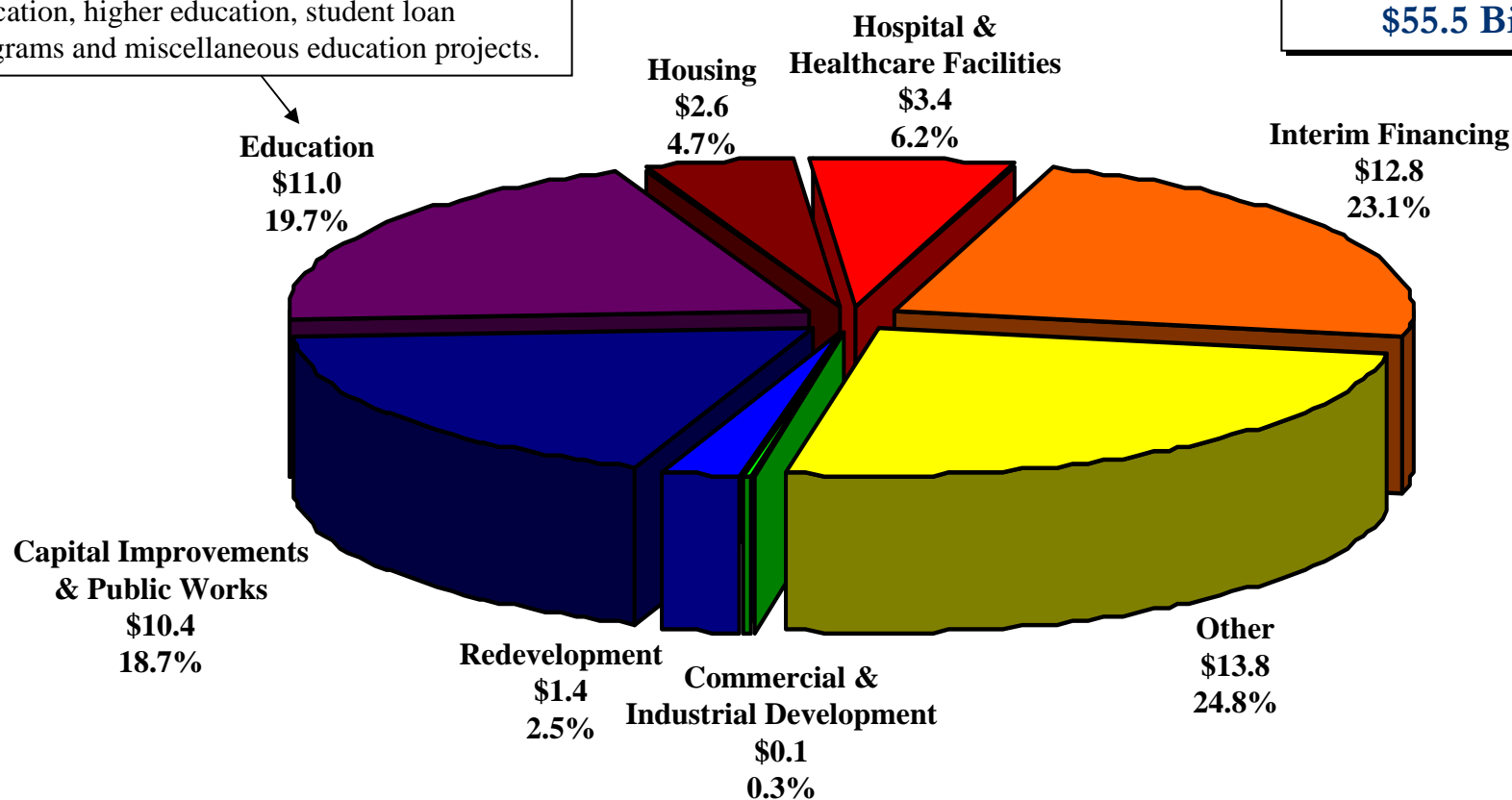
1. January 2005 - July 2005
Source: Thomson Financial (7/29/05)

Municipal Market Overview

2004 California Debt Issuance by Purpose (Dollars in Billions)

Includes issues sold for primary and secondary education, higher education, student loan programs and miscellaneous education projects.

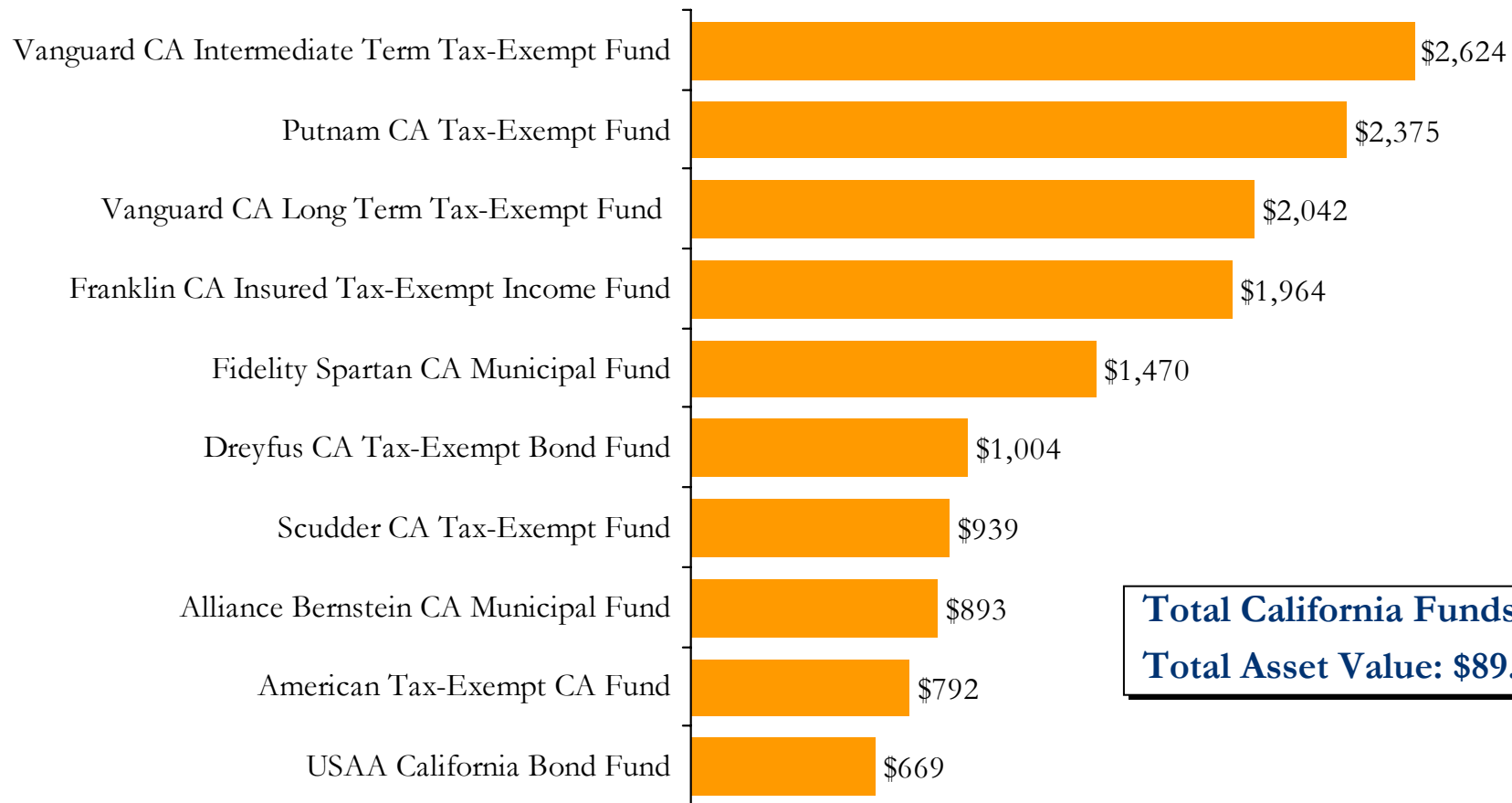
2004 California
Bond Volume:
\$55.5 Billion



Source: California Debt and Investment Advisory Commission

California Municipal Bond Funds

Top Ten California Municipal Bond Funds by Asset Value
(Dollars in Millions)



Total California Funds: 161
Total Asset Value: \$89.1B

Source: Bloomberg as of January, 2005

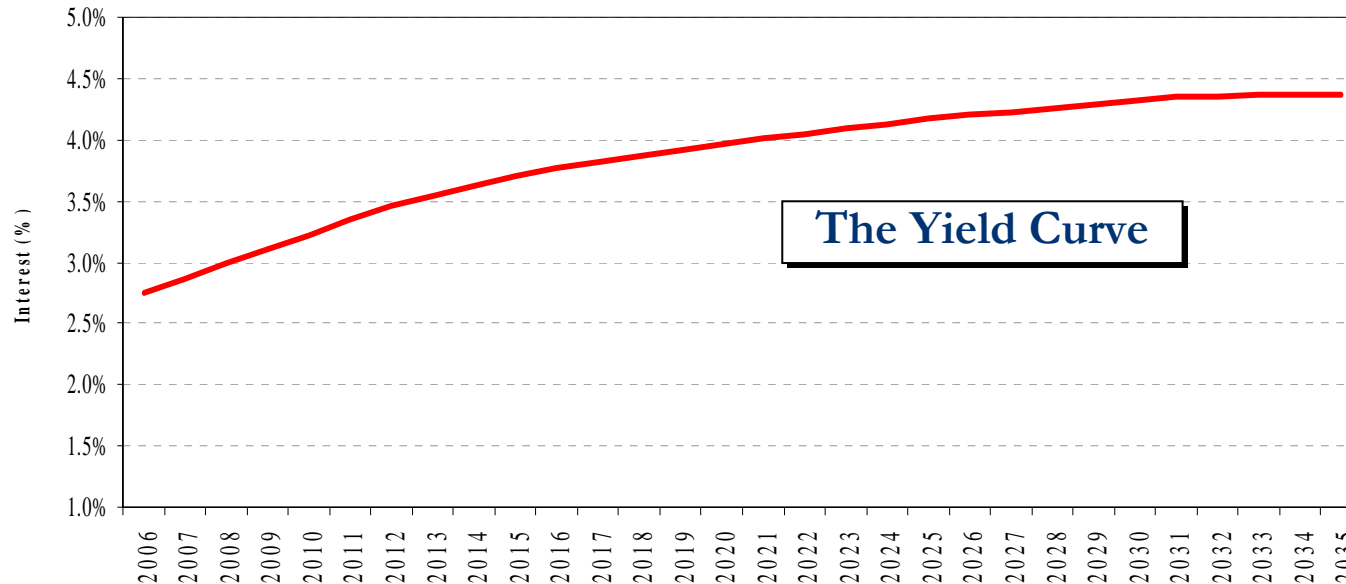
Buyers of Municipal Bonds

| Bond Buyers | Preferred Maturity Range | | |
|-----------------------------------|---------------------------|-----------------------------|------------------------------|
| | Short-Term (1-5 Years) | Medium-Term (6-15 Years) | Long-Term (16 Years Plus) |
| National Municipal Bond Funds | ✓ | ✓ | ✓ |
| Single-State Municipal Bond Funds | ✓ | ✓ | ✓ |
| Retail Investors | ✓ | ✓ | ✓ |
| Insurance Companies | | ✓ | ✓ |
| Bank Trust Departments | ✓ | | |
| Bank Portfolios | ✓ | ✓ | |
| Investment Advisors | ✓ | ✓ | |
| Money Market Funds ⁽¹⁾ | ✓ | | |
| Corporations | ✓ | | |

(1) Buyers of Bonds having maturities of thirteen months or less

Pre-Marketing Process (7-10 Days Prior)

1. **Design the proposed maturity structure and redemption provisions of the bonds within statutory, financial and interest rate constraints**



2. **Obtain credit ratings (General Obligation Bonds & Certificates of Participation)**
3. **Obtain final commitments from credit enhancement providers (if applied for)**
4. **Final review and completion of Preliminary Official Statement (POS)**
5. **Internet posting of POS with email alerts to prospective investors**

Source: Municipal Market Data as of 8/3/05

Pre-Marketing Process (1-2 Days Prior)

1. Preliminary Pricing Call with issuer

Discussion Topics:

- General market conditions
- Comparable sales in the market (see page 13)
- Timing of sale
- Visible Supply
- When is key economic news (i.e. jobs, CPI, PPI, etc.) scheduled to be released?
- Investor segments – where is the interest and how do we effectively market the bonds to those market segments?

2. Determine initial interest rates and yields with issuer

3. Set date, time and duration of bond order period

4. Initial pricing information distributed internally to all retail and institutional sales staff (and with co-managers if syndicate)

5. Set up Online Order Entry System and forward link to issuer (see page 14)

Day of Sale

- 1. Underwriter evaluates market conditions at the open**
 - A. Treasury bond prices**
 - B. Tone of tax exempt market – investor demand**
 - C. Comparable new issue sales**
 - D. Secondary market activity**
 - E. Final adjustments (if any) to initial coupons and yields**
- 2. Order period commences**
- 3. Send out pricing wire to solicit orders from target markets**
- 4. Underwriter keeps a master list of all orders from salespeople, including all members of any syndicate or selling group**
- 5. At conclusion of order period (3 – 4 hours) conference call between issuer, banker and underwriter to discuss sale status**
- 6. Repricing Considerations:**
 - A. Usually when all bonds are sold out quickly, the price is too “cheap” (yields too high) and the underwriter will look to raise prices on some or all of the maturities to bring the issue more in line with the market.**
 - B. When the bonds are not selling in the order period, it usually means the opposite. The bonds are too “expensive” (yields too low) and the underwriter may have to “sweeten the deal” by raising yields on some or all of the maturities to entice investors to place orders.**

Day of Sale (con't)

- 7. When a significant number of bonds have been sold, the managing underwriter will commit to purchase all unsold bonds at the advertised rates**
- 8. If the underwriter and issuer reach agreement on the final structure, interest rates (coupons) and yields of the bonds, then the terms are entered on a bond purchase agreement (BPA) presented for approval to the issuer**
- 9. The Bond Purchase Agreement (BPA) is executed by the issuer and the underwriter**
- 10. Investor orders are confirmed**
- 11. Preparations are made for closing the bonds (2-3 weeks following sale) and delivery of bond proceeds to the issuer**

Comparable Financings

Recent California Non-Rated Tax-Exempt Comparable Sales

| | Temecula Valley USD CFD No. 2002-2 | | | City of Lake Elsinore CFD No. 2004-3 | | | City of Roseville Westpark CFD No. 1 | | | Temecula Public Financing Authority CFD No. 03-1 Series 2005-B | | | Vacaville NE Sector AD Refunding Improvement Bonds Series 2005-B | | |
|------------------------|---------------------------------------|---|--------|---|---|--------|---|---|--------|--|---|--------|--|--------|--------|
| Pricing: | 8/11/2005 | | | 8/11/2005 | | | 8/10/2005 | | | 8/4/2005 | | | 8/3/2005 | | |
| Par Amount: | \$12,940,000 | | | \$22,675,000 | | | \$57,905,000 | | | \$3,865,000 | | | \$6,755,000 | | |
| Financing Type: | Special Tax | | | Special Tax | | | Special Tax | | | Special Tax | | | Special Tax | | |
| Value to Lien: | 23 to 1 | | | 3 to 1 | | | 7.7 to 1 | | | 14.9 to 1 - 22.0 to 1 | | | 20.3 to 1 | | |
| Underwriter: | Stone & Youngberg | | | Southwest Securities | | | Stone & Youngberg | | | Stone & Youngberg | | | Stone & Youngberg | | |
| | | | | | | | | | | | | | | | |
| 2006 | 2.700% | | | | | | | | | 2.700% | | | 2.800% | | |
| 2007 | 2.950% | | | 3.450% | | | 3.200% | | | 2.950% | | | 3.000% | | |
| 2008 | 3.200% | | | 3.750% | | | 3.500% | | | 3.200% | | | 3.350% | | |
| 2009 | 3.600% | | | 4.150% | | | 3.900% @ 3.950% | | | 3.600% | | | 3.700% | | |
| 2010 | 3.750% | | | 4.250% @ 4.350% | | | 4.100% | | | 3.750% | | | 3.900% | | |
| 2011 | 3.950% | | | 4.450% | | | 4.200% @ 4.250% | | | 3.950% | | | 4.050% | | |
| 2012 | 4.150% | | | 4.500% @ 4.600% | | | 4.300% @ 4.400% | | | 4.100% | | | 4.150% | | |
| 2013 | 4.350% | | | 4.500% @ 4.650% | | | 4.350% @ 4.500% | | | 4.200% | | | 4.300% | | |
| 2014 | 4.450% | | | 4.625% @ 4.750% | | | 4.500% @ 4.650% | | | 4.350% | | | 4.450% | | |
| 2015 | 4.500% | @ | 4.550% | 4.700% | @ | 4.850% | | | | 4.450% | | | 4.600% | | |
| 2016 | 4.600% | @ | 4.650% | 4.750% | @ | 4.900% | 5.00% | @ | 4.800% | 4.500% | @ | 4.550% | 4.625% | @ | 4.700% |
| 2017 | 4.650% | @ | 4.750% | 4.800% | @ | 4.950% | 5.250% | @ | 4.900% | 4.600% | @ | 4.650% | 4.750% | @ | 4.800% |
| 2018 | 4.700% | @ | 4.800% | 4.875% | @ | 5.000% | 5.250% | @ | 4.950% | 4.625% | @ | 4.700% | 4.850% | @ | 4.900% |
| 2019 | 4.750% | @ | 4.850% | | | | 5.250% | @ | 5.000% | 4.700% | @ | 4.750% | 4.875% | @ | 4.950% |
| 2020 | 4.850% | @ | 4.900% | | | | 5.000% | @ | 5.050% | 4.750% | @ | 4.800% | | 5.000% | |
| 2021 | | | | | | | | | | 4.800% | @ | 4.850% | | | |
| 2022 | | | | 5.100% | | | | | | 4.800% | @ | 4.900% | 5.000% | @ | 5.030% |
| 2023 | | | | | | | | | | 4.850% | @ | 4.950% | | | |
| 2024 | | | | | | | | | | | | | | | |
| 2025 | 5.000% | @ | 4.980% | 5.150% | | | 5.250% | | 5.100% | | | | | | |
| 2026 | | | | | | | | | | | | | | | |
| 2027 | | | | | | | | | | | | | | | |
| 2028 | 5.000% | | | | | | | | | | | | | | |
| 2029 | | | | | | | | | | | | | | | |
| 2030 | | | | 5.250% | | | 5.150% | | 5.200% | 5.000% | | | | | |
| 2031 | 5.000% | @ | 5.070% | | | | | | | | | | | | |
| 2032 | | | | | | | | | | | | | | | |
| 2033 | | | | | | | | | | | | | | | |
| 2034 | | | | | | | | | | | | | | | |
| 2035 | 5.125% | | | 5.250% | @ | 5.280% | | | | 5.000% | @ | 5.070% | | | |
| 2036 | | | | | | | 5.200% | @ | 5.220% | | | | | | |

Online Order Entry System

View Issue Data

\$12,940,000

Temecula Valley Unified School District
Community Facilities District No. 2002-2 Series 2005 Special Tax Bonds
State of CA

Stone & Youngberg LLC

| | | | |
|--|--|-----------------------------------|----------------------------------|
| Full Issue Description | Community Facilities District No. 2002-2 Series 2005 Special Tax Bonds | | |
| Dated Date | 8/25/2005 | Interest Accrual Date | 08/25/2005 |
| Fed Tax Exempt | Yes | BQ | No |
| Tax Exempt (State of Issue) | Yes | AMT | No |
| Pay Formula | 30/360 | Bond Counsel | Bowie, Arneson, Wiles & Giannone |
| Pay Frequency | Semi-Annually | Letter of Credit Provider | |
| First Coupon | 3/1/2006 | Letter of Credit Exp. Date | |
| Delivery Date | 8/25/2005 (Est.) | Insurance | N/A |
| Clearance | Book Entry | Underlying Rating | |
| Call Features for Call Schedule 'A' | 3/1/2006 @ 102 9/1/2015 @ Par | Rating | NR /NR /NR |
| Comments | | | |

Link to
Official
Statement
and Other
Issuer Info

Individual or
Institutional
Investors are able
to enter orders for
new issues during
the initial order
period

Order Period Closes at: Aug 11 2005 12:20

View Your Bond Issues

Issuer Clients
are able to
monitor order
flow during
order period

Refresh Screen

Order Summary

| MATURITY | PAR | CPN | YLD | ORDER COUNT | TOTAL ORDERS | OVER- SUBSCRIBED by | BALANCE (\$000's) |
|---------------|---------------|-------|-------|----------------|-----------------|---------------------------|----------------------|
| 9/1/2006 | 10 | 2.700 | 2.700 | 2 | 20 | 2.00 x | -10 |
| 9/1/2007 | 35 | 2.950 | 2.950 | 4 | 115 | 3.29 x | -80 |
| 9/1/2008 | 50 | 3.200 | 3.200 | 4 | 175 | 3.50 x | -125 |
| 9/1/2009 | 70 | 3.600 | 3.600 | 5 | 255 | 3.64 x | -185 |
| 9/1/2010 | 85 | 3.750 | 3.750 | 5 | 345 | 4.06 x | -260 |
| 9/1/2011 | 105 | 3.950 | 3.950 | 4 | 275 | 2.62 x | -170 |
| 9/1/2012 | 125 | 4.150 | 4.150 | 7 | 395 | 3.16 x | -270 |
| 9/1/2013 | 145 | 4.350 | 4.350 | 5 | 320 | 2.21 x | -175 |
| 9/1/2014 | 165 | 4.450 | 4.450 | 3 | 350 | 2.12 x | -185 |
| 9/1/2015 | 190 | 4.500 | 4.550 | 4 | 365 | 1.92 x | -175 |
| 9/1/2016 | 215 | 4.600 | 4.650 | 4 | 340 | 1.58 x | -125 |
| 9/1/2017 | 240 | 4.650 | 4.750 | 9 | 285 | 1.19 x | -45 |
| 9/1/2018 | 270 | 4.700 | 4.800 | 4 | 280 | 1.04 x | -10 |
| 9/1/2019 | 300 | 4.750 | 4.850 | 4 | 175 | 0 x | 125 |
| 9/1/2020 | 330 | 4.850 | 4.900 | 9 | 385 | 1.17 x | -55 |
| 9/1/2025 | 2,230 | 5.000 | 4.980 | 7 | 4,625 | 2.07 x | -2,395 |
| 9/1/2028 | 1,875 | 5.000 | 5.000 | 14 | 1,420 | 0 x | 455 |
| 9/1/2031 | 2,380 | 5.000 | 5.070 | 5 | 6,275 | 2.64 x | -3,895 |
| 9/1/2035 | 4,970 | 5.125 | 5.125 | 25 | 5,735 | 1.15 x | -765 |
| Totals | 13,790 | | | 124 | 22,135 | | 580 |

Sample Bond Pricing: Sources & Uses

\$12,940,000

Temecula Valley Unified School District

Community Facilities District No. 2002-2 (Redhawk II)

Sale Date: 8/11/05

| | |
|-----------------------------|-----------------|
| Dated Date | 8/25/2005 |
| Delivery Date | 8/25/2005 |
| Sources of Funds | |
| Par Amount | \$12,940,000.00 |
| Original Issue Discount | -31,744.45 |
| | <hr/> |
| | \$12,908,255.55 |
| Uses of Funds | |
| School Construction Account | \$11,388,147.49 |
| Debt Service Reserve Fund | 1,133,008.06 |
| Cost of Issuance | 193,000.00 |
| Underwriter's Discount | 194,100.00 |
| | <hr/> |
| | \$12,908,255.55 |

Sample Bond Pricing: Bond Statistics

\$12,940,000

**Temecula Valley Unified School District
Community Facilities District No. 2002-2 (Redhawk II)**

Sale Date: 8/11/05

| | |
|---------------------------------|---------------|
| Dated Date | 8/25/2005 |
| Delivery Date | 8/25/2005 |
| Last Maturity | 9/1/2035 |
| Arbitrage Yield | 5.018127% |
| True Interest Cost (TIC) | 5.136348% |
| Net Interest Cost (NIC) | 5.095672% |
| All-In TIC | 5.256548% |
| Average Coupon | 5.016267% |
| Average Life (years) | 21.980 |
| Duration of Issue (years) | 13.099 |
| Par Amount | 12,940,000.00 |
| Bond Proceeds | 12,908,255.55 |
| Total Interest | 14,267,300.26 |
| Net Interest | 14,493,144.71 |
| Total Debt Service | 27,207,300.26 |
| Maximum Annual Debt Service | 1,203,681.26 |
| Average Annual Debt Service | 906,406.45 |
| Underwriter's Fees (per \$1000) | |
| Average Takedown | 0 |
| Fees | 15.000000 |
| Total Underwriter's Discount | 15.000000 |
| Bid Price | 98.25467968 |

| Bond Component | Par Value | Price | Average Coupon | Average Life |
|----------------|-------------|---------|----------------|--------------|
| Serial Bond | \$2,335,000 | 99.519 | 4.595% | 10.676 |
| Term Bond 2025 | 2,230,000 | 100.155 | 5.000% | 18.201 |
| Term Bond 2028 | 1,875,000 | 100.000 | 5.000% | 22.070 |
| Term Bond 2031 | 2,380,000 | 98.993 | 5.000% | 25.067 |
| Term Bond 2035 | 4,120,000 | 100.000 | 5.125% | 28.608 |

| | TIC | All-In TIC | Arbitrage Yield |
|----------------------------|----------------|----------------|-----------------|
| Par Value | \$5,690,000.00 | \$5,690,000.00 | \$5,690,000.00 |
| + Accrued Interest | | | |
| + Premium (Discount) | -20,672.65 | -20,672.65 | -20,672.65 |
| - Underwriter's Discount | -142,250.00 | -142,250.00 | |
| - Cost of Issuance Expense | | -176,000.00 | |
| - Other Amounts | | -15,000.00 | |
| Target Value | \$5,527,077.35 | \$5,336,077.35 | \$5,669,327.35 |
| Target Date | 1/27/2005 | 1/27/2005 | 1/27/2005 |
| Yield | 5.609720% | 5.892554% | 5.408354% |

Sample Bond Pricing

\$12,940,000

**Temecula Valley Unified School District
Community Facilities District No. 2002-2 (Redhawk II)
Sale Date: 8/11/05**

| Date | Principal | Coupon | Yield | Price | Premium or Discount | \$ Premium (Discount) |
|-------------|------------------|---------------|--------------|--------------|--------------------------------|----------------------------------|
| 09/01/06 | \$10,000 | 2.700% | 2.700% | 100.000 | Par | \$0.00 |
| 09/01/07 | 35,000 | 2.950% | 2.950% | 100.000 | Par | 0.00 |
| 09/01/08 | 50,000 | 3.200% | 3.200% | 100.000 | Par | 0.00 |
| 09/01/09 | 70,000 | 3.600% | 3.600% | 100.000 | Par | 0.00 |
| 09/01/10 | 85,000 | 3.750% | 3.750% | 100.000 | Par | 0.00 |
| 09/01/11 | 105,000 | 3.950% | 3.950% | 100.000 | Par | 0.00 |
| 09/01/12 | 125,000 | 4.150% | 4.150% | 100.000 | Par | 0.00 |
| 09/01/13 | 145,000 | 4.350% | 4.350% | 100.000 | Par | 0.00 |
| 09/01/14 | 165,000 | 4.450% | 4.450% | 100.000 | Par | 0.00 |
| 09/01/15 | 190,000 | 4.500% | 4.550% | 99.600 | Discount | (760.00) |
| 09/01/16 | 215,000 | 4.600% | 4.650% | 99.571 | Discount | (922.35) |
| 09/01/17 | 240,000 | 4.650% | 4.750% | 99.091 | Discount | (2,181.60) |
| 09/01/18 | 270,000 | 4.700% | 4.800% | 99.039 | Discount | (2,594.70) |
| 09/01/19 | 300,000 | 4.750% | 4.850% | 98.990 | Discount | (3,030.00) |
| 09/01/20 | 330,000 | 4.850% | 4.900% | 99.471 | Discount | (1,745.70) |
| 09/01/25 | 2,230,000 | 5.000% | 4.980% | 100.155 | Premium | 3,456.50 |
| 09/01/28 | 1,875,000 | 5.000% | 5.000% | 100.000 | Par | 0.00 |
| 09/01/31 | 2,380,000 | 5.000% | 5.070% | 98.993 | Discount | (23,966.60) |
| 09/01/35 | 4,120,000 | 5.125% | 5.125% | 100.000 | Par | 0.00 |

Net Original Issue Discount (\$31,744.45)

Underwriters' Compensation: Overview

- **Underwriter's discount is present in both negotiated and competitive sales**
- **Discounts vary due to credit quality of securities (insured, rated or non-rated)**
- **Component amounts generally move in inverse relationship to the size of the issue**

Underwriters' Compensation: Components

Four Components

- **Management Fee - Investment banking, Syndicate manager**
- **Takedown - Compensation for the sales effort**
- **Underwriting Risk - Compensation to underwrite securities not presold**
- **Expenses - Reimbursable out-of-pocket expenses of the underwriter**
 - **Underwriter's Counsel**
 - **Regulatory Fees - MSRB, PSA, CDIAC**
 - **Travel, FedEx, messenger, conference calls, etc.**

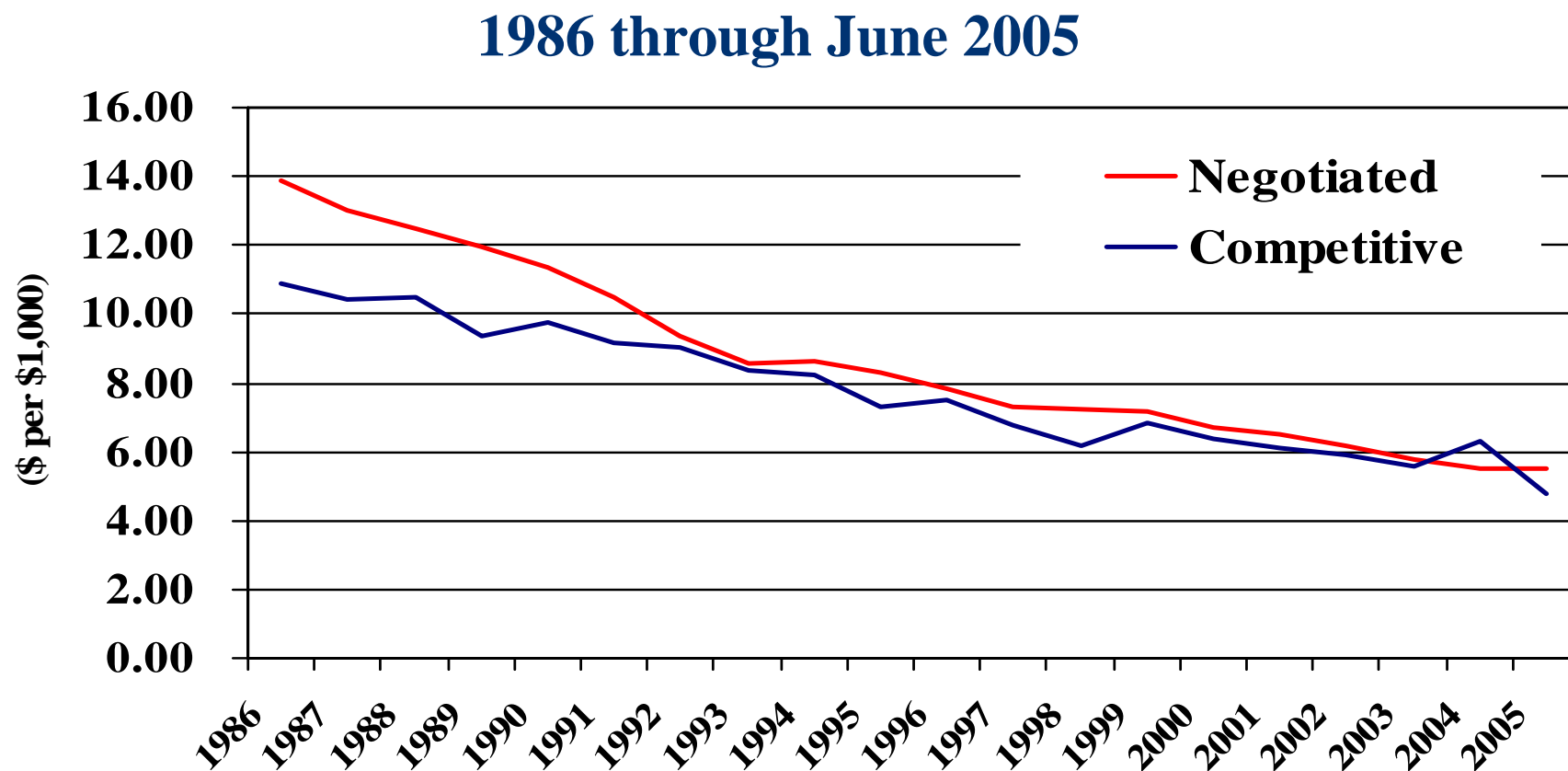
Underwriters' Compensation: Example

\$15 Million – “A” Rated Financing

| Component | (\$/\$1,000) | Fee |
|-------------------------|--------------|---------------|
| Management Fee | \$1.33 | \$19,950 |
| Average Takedown | 4.14 | 62,100 |
| Underwriting Risk | 0.50 | 7,500 |
| Expenses ⁽¹⁾ | <u>1.90</u> | <u>28,500</u> |
| | \$7.87 | \$118,050 |

⁽¹⁾Includes Underwriter's Counsel fee of \$1.20/\$1,000 or \$18,000

Underwriters' Compensation: Historical



Source: Thomson Financial (7/9/05)



